these other regulations address the very same behavior targeted by the horizontal limit means that there is less need to impose an overly restrictive horizontal limit. This is even more true today than it was in 1993 given the fact that these other behavioral restrictions have proven successful and, in some cases, have been strengthened since adoption of the current horizontal limit.

a) Program Carriage Rules.

The program carriage rules prohibit a cable operator from discriminating against an unaffiliated programmer in the terms or conditions of carriage based on the programmer's nonaffiliation with the cable operator.[32] In the five years since the rules were adopted, only one program carriage case has been brought and it was settled among the parties.[33] The fact that no cable operator has ever been found to have violated the program carriage rules indicates that the type of discrimination and vertical foreclosure that is at the heart of the horizontal limit is not prevalent.

(... continued)

occupancy limits, and must-carry requirements all affect the way the cable television industry currently operates and have a profound effect on current industry structure and performance. . . . Because these provisions have real and substantive impact upon the market, the Commission, in setting the horizontal ownership limit, may properly consider the impact of these provisions in alleviating some of the public interest and anticompetitive concerns about horizontal concentration.").

[32] 47 U.S.C. § 536(a)(3); 47 C.F.R. § 76.1301(c).

[33] Classic Sports Network v. Cablevision Systems Corporation, 12 FCC Rcd 22100 (1997) (terminating proceeding pursuant to the parties' Joint Stipulation of Dismissal).

This record was not available when the Commission adopted the current horizontal limit.

b) Leased Access Rules.

The leased access rules require cable operators to provide access to non-affiliated video programmers at rates which the Commission has deemed reasonable.[34] In addition, cable operators must place leased access programmers on highly penetrated tiers and must treat such programmers in a non-discriminatory manner.[35] In 1997, the Commission strengthened its leased access rules to make it even easier and less expensive for unaffiliated commercial programmers to gain access to cable systems.[36] The D.C. Circuit recently upheld the Commission's revised rule.[37] Thus, leased access is an even greater check on cable operators foreclosure power today than it was in 1993.

c) Must Carry Rules.

An MSO's ability to limit diversity by dictating content is substantially in check due to the Supreme Court's affirmance of the current must carry rules.[38] At the time the current horizontal

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34 47 U.S.C. § 532.

35 47 C.F.R. § 76.970 et seq.

36 See Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Leased Commercial Access, Second Report and Order and Second Order on Reconsideration of the First Report and Order, 12 FCC Rcd 5267 (1997).

37 ValueVision International v. F.C.C., ___ F.3d ___, (Nos. 97-1138 and 97-1178) (D.C. Cir. July 24, 1998).

38 Turner Broadcasting System v. F.C.C., 520 U.S. 180 (1997).

limit was adopted, there was substantial uncertainty as to whether must carry could withstand constitutional scrutiny. In 1997, the Court upheld the constitutionality of the current must carry requirement. The Court's decision reduced cable's power to limit program diversity -- the very concern underlying the current horizontal limit.[39]

d) Channel Occupancy Rules.

The channel occupancy rules preclude a cable operator from devoting more than 40% of its channel capacity to video programmers in which it has attributable interest.[40] This limit was designed to protect against harm to video programmers resulting from vertical integration in the cable industry.[41] In the five years since adoption of the channel occupancy rules, not a single complaint has been brought alleging a violation of the rules. Again, this record, not available to the Commission in 1993, indicates that the vertical foreclosure concerns underlying the horizontal limit are not significant.

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39 1993 Second Report and Order at ¶ 6.

40 47 C.F.R. § 76.504(a). These limits apply only to 75 channels on a cable system. 47 C.F.R. § 76.504(b).

41 Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution and Carriage, Second Report and Order, 9 FCC Rcd 2642, at ¶¶ 14-15 (1993).

e) Program Access Rules.

The program access rules are designed to allow competing MVPDs access to vertically integrated programming on nondiscriminatory terms in order to promote competition in the provision of video programming.[42] A relatively small number of program access complaints have been filed, and relatively few have been decided in favor of the complainant.[43] In fact, the Commission has often cited the program access rules as a "necessary factor in the development of both the DBS and MMDS industries."[44] In addition, earlier this month, the Commission recently strengthened the program access rules by adopting damages as a potential remedy, imposing a shorter pleading cycle and time limits for the resolution of complaints, and making it easier for buying groups to purchase programming under favorable terms.[45]

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In short, the behavioral restrictions on which the Commission relied in part to justify the 30% limit have been strengthened in

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[42] 47 C.F.R. §§ 76.1001, 1002.

[43] Of 41 program access complaints filed with the Commission in five years, 8 have been decided against the defendant, 19 have been settled, 4 denied, 3 dismissed, 2 withdrawn, and 5 are pending.

[44] <u>1997 Video Competition Report</u> at ¶ 230; <u>see</u> <u>also</u> <u>1993 Second Report and Order</u> at ¶ 54 (noting that the program access rules promote diversity and provide alternative sources of unaffiliated programming).

[45] <u>See</u> <u>Petition for Rulemaking of Ameritech New Media, Inc.</u>, Report and Order, CS Docket No. 97-248, FCC 98-189 (rel. August 10, 1998).

some cases and in all cases have been an effective method of ensuring programming diversity and reasonable, non-discriminatory access to cable systems by unaffiliated services. The success and strengthening of these rules strongly supports the conclusion that the current horizontal limit should be increased. Stated another way, the Commission noted when it adopted the existing horizontal limit that these other vertical restrictions did address the concerns underlying the horizontal limit,[46] but because it had little experience with them at that time, it was not able to give them adequate weight. Now, the Commission does have experience with these other rules, and that experience reveals that they have a direct and material impact on monopsony power and vertical foreclosure. Therefore, the need for the overly restrictive 30% horizontal limit is reduced still further.

3. Principal Change #3: The Emergence And Widespread Deployment Of Digital Video Technology Has Created Additional Programming Outlets Since Adoption Of The Existing Limit.

At the time the Commission adopted the horizontal limit, digital technology was not used by a single MVPD. Today, cable and non-cable MVPDs alike use digital technology to expand channel capacity. All DBS providers now use digital technology to offer subscribers up to 220+ channels. MMDS operators also have begun to implement digital technology to expand their channel capacity.[47]

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[46] 1993 Second Report and Order at ¶ 26.

[47] In 1996, the Commission authorized MMDS operators as the first over-the-air terrestrial video programming service to use digital (continued ...)

And, beginning this Fall, broadcasters will begin to provide digital programming, which may enable them to provide multiple channels of programming. This increase in channel capacity further reduces concern about cable operators exerting monopsony power or engaging in vertical foreclosure by providing programmers with significant additional outlets for their program services.

In addition, the cable operators' own increased digital capacity will reduce the incentive to engage in vertical foreclosure or monopsony behavior.[48] Cable operators will have strong incentives, based upon the investment of enormous capital to create this new capacity, to fill it with quality services that appeal to their consumers, regardless of affiliation. The Commission itself recognized this phenomenon in the channel occupancy context when it eliminated application of such limits after 75 channels on a given cable system:

> We continue to believe that expanded channel capacity will reduce the need for channel occupancy limits. . . . [T]he expanded channel capacity that will result from fiber optic cable and digital compression technology will help obviate the need for such limits as a means of encouraging cable operators to

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(... continued)

technology. See In re Request for Declaratory Ruling on the Use of Digital Modulation by Multipoint Distribution Services, Declaratory Ruling and Order, 11 FCC Rcd 18839 (1996).

[48] See, e.g., "Cablevision, Comcast Go With Compression," Broadcasting, at 7 (February 22, 1993); see Testimony of Leo J. Hindery, Jr., President, Tele-Communications, Inc., Before the Senate Subcommittee on Antitrust, Business Rights, and Competition, October 8, 1997, at 3 ("Hindery Testimony") (TCI Digital Cable uses digital compression to offer 42 digital video channels with approximately 14 channels added every several months).

> carry unaffiliated or competing video programming services. . . . [T]he record indicates that vastly larger cable systems will likely be inclined to deliver targeted 'niche' video programming services aimed at correspondingly smaller audience sizes. . . .[49]

Thus, the Commission already has acknowledged that expanded channel capacity has the effect of discouraging cable operators from exercising monopsony power or engaging in vertical foreclosure. The Commission should apply this conclusion in the horizontal limit context as well.

B. New And Significant Empirical Evidence Demonstrates That There Is No Monopsony Or Vertical Foreclosure Problem Under Current MSO Concentration Levels.

The foregoing discussion is particularly persuasive given the fact that there is no evidence of monopsony or vertical foreclosure abuses under current MSO concentration levels. To the contrary, sources of independent programming have grown dramatically, and the amount and diversity of programming available to consumers through cable has reached an all time high. Moreover, new empirical evidence since adoption of the 1993 limit shows that cable operators do not disadvantage, and often actually favor, non-affiliated programming services.

1. Independent Programming Sources Have Experienced Substantial Growth.

Independent programming has flourished since the Commission adopted the horizontal limit in 1993. For example, the number of

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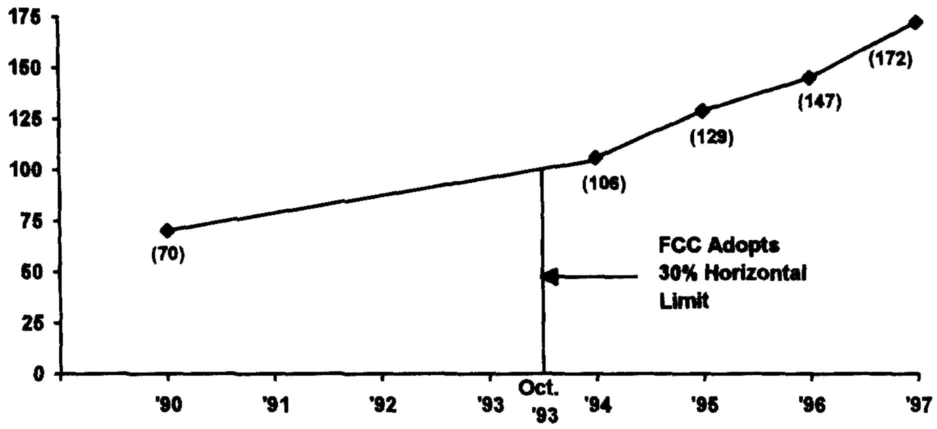
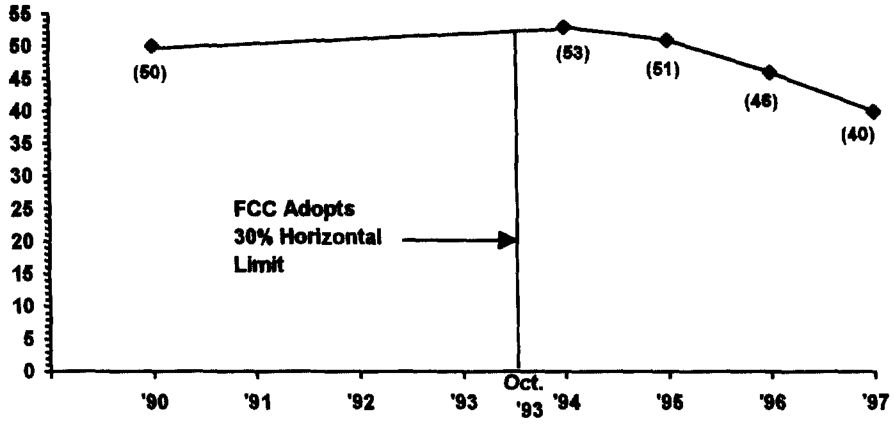
49 1993 Second Report and Order at ¶ 83.

national satellite services has increased, from 106 in 1994 to 172 in 1997. During this same time, the percentage of programmers vertically integrated with cable has declined from 53% to 40%. The charts below detail these trends. Of course, these developments are exactly what Drs. Besen, Brenner, and Woodbury; TCI; and others predicted in 1993.

Number of National Satellite Programming Services 1990-1997



Percentage of Vertically Integrated National Satellite Programming Services 1990-1997



Sources: Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Fourth Annual Report, FCC 97-423, at ¶ 158 (1998); First Annual Report, FCC 94-235, at ¶ 161 & n. 434 (1994).

The Commission itself recognized this growth of additional programming services in its Second Order on Recon.: "It appears that the current level of concentration among cable MSOs has not prevented an expansion in programming sources and networks."[50] It also recently observed a trend by existing service providers, regardless of whether they are vertically integrated with MSOs, to create additional programming services.[51] As the Commission's latest video competition report indicates, over 70 national programming services unaffiliated with cable operators are planned to be launched in the near future, whereas only 5 national programming services affiliated with a cable operator are planned for launch.[52] In short, the actual evidence demonstrates that independent programming sources have flourished over the last several years and that this activity is likely to continue. This evidence fully supports relaxation of the current horizontal limit.

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[50] Second Order on Recon. at ¶ 43.

[51] 1997 Video Competition Report at ¶ 164. For example, Viacom and the Walt Disney Company, program providers unaffiliated with any MVPD, recently launched additional programming services. Viacom's MTV recently launched M2, and Disney's ESPN recently launched ESPNEWS. See id.

[52] See id. at Tables F-3 and F-4. See also discussion at Section IV.B.2.c), infra, regarding the significant number of national satellite program services that have flourished even with subscriber penetration levels well below 60% (the inverse of TCI's 40% subscriber limit proposal).

2. **New Empirical Evidence Disproves Any Claim Of A Cable Monopsony Or Vertical Foreclosure Problem.**

There is now new empirical evidence since the 30% limit was adopted demonstrating that there is no current (or foreseeable) monopsony or vertical foreclosure problem. This evidence is summarized in the attached economic analysis by Besen and Woodbury. Besen and Woodbury conclude that "TCI does not favor affiliated programming services in any way that significantly forecloses non-affiliated programming."[53] Furthermore, they find:

> On average, the extent of carriage on TCI systems is less for all services, owned or otherwise. For services in which TCI has an ownership interest, the average carriage rate on TCI systems is about 6 percentage points less than on other systems. For services in which TCI has no ownership interest, the average carriage rate on TCI systems is about 3 percentage points less than that for non-TCI systems. Thus, these data indicate that, relative to its owned services, **TCI actually favors non-affiliated services.**[54]

Besen and Woodbury go on to say that "[t]his evidence is inconsistent with the view that TCI or other vertically integrated cable operators have historically attempted to disadvantage rival cable program services, and provides no support for the proposition that such conduct would likely take place in the future."[55]

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53 Besen and Woodbury at A-1.

54 Id. at A-2 (all emphases in original).

55 Id. A-1.

Although some TCI subscribers may not have access to certain non-affiliated services available to other TCI subscribers, the percentage of TCI subscribers without access to affiliated services is higher.[56] Thus, more non-affiliated services are advantaged than disadvantaged by TCI:

> In sum, while some non-affiliated services are available to fewer TCI subscribers than to subscribers to comparable unintegrated systems, the extent of the affected market is too small to be seen as the outcome of a foreclosure strategy or to have a significant effect on competition. Indeed, by this standard, nearly one-third of the TCI-affiliated programming services studied here are also disadvantaged -- **and importantly, more non-affiliated services are advantaged than disadvantaged by TCI.**[57]

Besen and Woodbury also provide a summary of a number of other studies which have specifically examined TCI's carriage behavior, all with the same result:

> Crandall found that TCI systems were significantly more likely to carry both affiliated and unaffiliated program services than were systems that were not affiliated with any service, indicating no evidence of discrimination against unaffiliated services. When we compared TCI carriage rates with those of non-TCI systems without controlling for other differences among systems, we found that, relative to its owned program services,

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56 See id. at A-6 ("TCI 'forecloses' about one-third of the 19 TCI-affiliated services considered by [Charles River Associates] in this analysis. Indeed, the typical percentage of TCI subscribers without access to these affiliated services (the typical gross foreclosure rate) is about 8.5%, an average that is higher than that for the disadvantaged non-affiliated services.") (emphasis in original).

57 Id. at A-7 (all emphases in original).

> TCI _favors_ unaffiliated services. Moreover, we found no significant relationship between TCI's carriage behavior and the magnitude of its ownership interest in a program service.[58]

The conclusion that TCI is not driven by a foreclosure strategy was confirmed once again most recently in TCI's rate survey response filed with the Commission on June 18, 1998. TCI reported that on average it has 10 affiliated services and 33 unaffiliated services on each of its cable systems.[59] Moreover, from 1996 to 1997, TCI's costs for _affiliated_ programming rose 18%, while its costs for _unaffiliated_ programming rose 29%. Similarly, from 1997 to 1998, TCI's cost of _affiliated_ programming rose 12%, compared with an increase for _unaffiliated_ programming of 16%.

All this evidence -- which was not available to the Commission when it adopted the current horizontal limit -- suggests that TCI makes its carriage decisions based on customer demands for the services rather than on a foreclosure strategy.[60]

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58 Besen and Woodbury at 20 and n.15.

59 Letter from Richard D. Treich, Tele-Communications, Inc., to John E. Logan, Acting Chief, Cable Services Bureau, Federal Communications Commission regarding Response to Cable Rates Inquiry, at 6 (June 18, 1998).

60 _See_ Besen and Woodbury at A-7 ("These results comport with the view that TCI's carriage decisions are largely, if not solely, determined by which services are profitable to offer cable subscribers, without regard to the effect of those carriage decisions on TCI's competitive position in the supply of program services."); _see also_ Michael W. Klass and Michael A. Salinger, "Do New Theories of Vertical Foreclosure Provide Sound Guidance for Consent Agreements in Vertical Merger Cases?," _The Antitrust Bulletin_ (Fall 1995), p. 692 ("[T]here is no empirical basis for concluding that vertical integration or mergers [in the cable industry] are, on balance, anticompetitive. Thus, in this case,

(continued ...)

Finally, Besen and Woodbury reviewed whether vertically integrated cable systems as a class favor program services in which they have ownership interests and foreclose program services that compete with the services they own. This review was based on evidence from the public literature, as well as the results of CRA's own analyses of cable operator program carriage activity. Besen and Woodbury conclude:

> The bulk of the empirical evidence indicates that vertically integrated cable operators do not disfavor non-pay program services in which they do not have ownership interests. In particular, carriage rates for these services by vertically integrated systems are generally not lower than those of systems that are not vertically integrated. . . . Similarly, there is little or no evidence of the foreclosure of pay services. While most studies find that cable systems that are integrated with pay services tend to carry rival pay services less frequently than do unintegrated systems, (which is an unremarkable finding because of the efficiencies of vertical integration), the magnitude of the extent to which disadvantaged rivals are denied access to the subscriber universe is quite small.[61]

This evidence demonstrates that there is no significant monopsony or vertical foreclosure problem and, when coupled with the changed marketplace circumstances discussed above, strongly supports a higher cable horizontal limit.[62] This conclusion is

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there does not appear to be an empirical basis for challenging vertical mergers or seeking or accepting sweeping consents.").

[61] Besen and Woodbury at 19.

[62] Moreover, as Besen and Woodbury point out, there is an additional hurdle an MSO would encounter even if it wanted to
(continued ...)

entirely consistent with the recommendations made by the Justice Department to the Commission when the Commission was initially considering adoption of a cable horizontal limit:

> Under the conditions existing in the cable industry, it is not clear to us that placing limits on the number or percentage of subscribers that a single MSO may serve, either on a national or regional basis, is an effective way to reduce local market power. Nor is it clear that there is any need for general regulatory limits on cable system size to prevent the exercise of any monopsony power that would curtail programming output. ... It is noteworthy that despite the increase in concentration in the cable distribution business that has occurred over the last few years more rather than less programming is being produced for cable distribution. That is not to say that large cable systems may not have significant bargaining power when they confront program suppliers, some of whom may also possess considerable bargaining power. But bargaining power should not be confused with monopsony power where the record before the Commission includes neither structural analysis nor empirical observation indicating any imminent danger that the number of programming services will be reduced as a result of increases in the number of subscribers served by individual MSOs.[63]

(... continued)

engage in a foreclosure strategy, namely the possibility that other cable systems that would be disadvantaged if a rival program service were foreclosed may have an incentive to attempt to keep the rival in business by adopting counterstrategies to the attempt to foreclose, such as making payments to the disadvantaged program service that prevent it from going out of business. This may make the foreclosure strategy unprofitable, so it may not be pursued in the first place. See Besen and Woodbury at 11-12.

[63] Reply Comments of the United States Department of Justice in Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600, at 5-6 (filed April 2, 1990) ("1990 DOJ Reply Comments") (all emphases added).

The Department concluded that "based on the record before the Commission there is considerable doubt regarding the basis for any regulation imposing generally applicable maximum size limits on MSOs."[64] TCI fully concurs with DOJ's assessment and contends that its conclusions are even more relevant today given the lack of evidence of monopsony and/or vertical foreclosure abuses by MSOs at current concentration levels, as well as contrary evidence regarding the vibrant programming marketplace. Nonetheless, TCI is not calling for an aggressive adjustment in the horizontal limit, nor for its elimination as DOJ's analysis would suggest. Rather, it is merely seeking a modest increase in the limit that reflects the changed marketplace circumstances discussed above and the new evidence regarding the absence of vertical foreclosure or monopsony abuses, and which allows moderate, pro-consumer growth to continue.

C. The History Of The Government's Attempts To Regulate The Relationship Between Program Distributors And Program Suppliers Further Supports A Higher Cable Horizontal Limit.

1. As A General Matter, Regulation Of The Programmer-Distributor Relationship Provides Little, If Any, Consumer Benefit.

Theoretically, at the extreme end, the division of money between video programmers and distributors could become sufficiently skewed as to endanger the financial survival of video programmers, a scenario in which the Commission would play an appropriate role. However, as these comments and the attached

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64 Id. at 45.

economic analysis demonstrate through quantitative analysis, this simply is not occurring. The number of programmers is increasing. Moreover, the magnitude and duration of the success of many video programmers suggests that the minimum number of subscribers necessary for success is much lower than has traditionally been assumed. Practically viewed, the continued discussion of the monopsony argument is a veiled call for wealth redistribution -- a function wholly inappropriate for the Commission to undertake, particularly in light of the robust financial health of video programmers today.

The Commission's ultimate responsibility is the protection of consumers. Even if cable operators possess monopsony power, that fact, alone, would not suggest a potential decline in consumer welfare. To the contrary, if a cable operator's costs decline -- even as a result of the exertion of its monopsony power over video programmers -- consumers will experience benefits in the form of lower rates.[65] No evidence has been proffered to suggest that consumers are harmed by the current relationship of cable operators and video programmers.

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[65] See J. Tirole, The Theory of Industrial Organization, Cambridge, MA: MIT Press, 1989, pp. 66-67; O.E. Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs," American Economic Review, vol. 68, pp. 18-36 (March 1968).

2. The Fin-Syn And Movie Theater Consent Decree Precedent Illustrates The Pitfalls Of Regulating The Programmer-Distributor Relationship And The Importance Of Relaxing Such Restrictions When Marketplace Circumstances Change.

As well-established precedent demonstrates, government intervention in the relationship between program distributors and program suppliers for the purpose of decreasing monopsony power and vertical foreclosure and/or increasing program diversity is often ill-advised and contrary to the public interest. In the past, the Commission and other governmental bodies have attempted to untangle the thorny question of how much horizontal distribution concentration is too much in the context of programmer-distributor relationships. As the discussion below illustrates, the government's experience with regulating such relationships proves that: (1) the program diversity concerns that underlie the restrictions often were more theoretical than real; (2) the restrictions actually weakened, rather than strengthened, the programming community; and (3) the restrictions should be relaxed, or eliminated, where increased competition develops in the underlying program distribution marketplace.

This precedent suggests that the Commission should not micromanage the programmer-distributor relationship in the cable industry by attempting to divine the perfect horizontal limit. Rather, it should recognize, as it has in the past, that horizontal concentration produces benefits for programmers and distributors alike and that the significant marketplace changes discussed above, including increased MVPD competition, fully justify adjusting the current limit in a manner that provides the flexibility necessary to allow these benefits to continue.

a) The Fin-Syn Rules.

The Commission confronted a relatively recent iteration of the programmer-distributor issue during the drawn-out battle over the purchase and distribution rights of programmers and television networks. This engagement resulted in the financial interest, syndication, and prime-time access rules, together the "fin-syn" rules.[66]

The Commission promulgated the fin-syn rules to encourage the "development of diverse and antagonistic sources of program service" by restraining network power, and maintaining demand for non-network programming.[67] The Commission reasoned that networks -- ABC, CBS, and NBC -- without any restraints on horizontal ownership would attempt to convert their market position into enhanced program purchasing power. This would result in a network obtaining depressed prices for programming and/or extracting

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[66] The fin-syn rules refer collectively to three independent, but interrelated, rules. First, the financial interest rules prohibited any television network (defined by the Commission) from acquiring any interest, beyond the license to air programming on its network, in any programming not produced in-house. Second, the syndication rules prohibited any television network from becoming a distributor, i.e., the network itself may not syndicate a program after initially airing the program on its network. Finally, the prime time access rule ("PTAR") limited the amount of network-produced shows that a network could air during certain defined "prime time" television hours.

[67] See Network Television Broadcasting, 23 F.C.C.2d 382, at ¶ 37 (1970).

valuable rights from producers, such as equity positions in programming. Programmers, thus, would find it difficult to operate at a profit, either because they sacrificed profits or equity in exchange for network access. Furthermore, without the PTAR, the networks would foreclose program diversity by shifting their programming resources to producing in-house programming and airing it during the valuable prime time hours, thus dampening or killing demand for non-network programming. In other words, the fin-syn rules addressed the very same goals as the horizontal limit: the prevention of monopsony power and foreclosure of diverse programming.

In 1992, the fin-syn rules were considered on appeal to the Seventh Circuit Court of Appeals. The court focused on three primary reasons why the rationale for the rules was faulty:

- **The link between the rules and the harm they were intended to prevent was illusory.**

The court stated:

> The basis for [the Commission's] concern that the networks, octopus-like, would use their position in distribution to take over programming, and would use the resulting control of programming to eliminate their remaining competition in distribution, was never very clear.[68]

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[68] Schurz Communications, Inc. v. F.C.C., 982 F.2d 1043, 1046 (7th Cir. 1992).

- **The fin-syn rules weakened, rather than strengthened, the programming community.**

The court concluded that the implementation of the rules coincided with -- and indeed, contributed to -- the weakening of the programming community:

> [C]ontrary to the intention behind the rules yet an expectable result of them because they made television production a riskier business, the production of prime-time programming has become more concentrated. There are 40 percent fewer producers of prime-time programming today than there were two decades ago. And the share of that programming accounted for directly by the eight largest producers, primarily Hollywood studios-- companies large enough to bear the increased risk resulting from the Commission's prohibition against the sale of syndication rights to networks--has risen from 50 percent to 70 percent.[69]

In other words, the Commission's good faith efforts to manage the relationships between programmers (in both the program supply and program distribution markets) and networks (in both the program demand and program distribution markets) had dire unintended consequences.

- **Dramatic market changes further undermined the rules' necessity.**

From the period of the fin-syn rules' inception in the late 1960's to their abolition in the early 1990's, the video distribution markets changed tremendously:

> Whatever the pros and cons of the original financial interest and syndication rules, in the years since they were promulgated the

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[69] Id. at 1046-47.

> structure of the television industry has changed profoundly. The three networks have lost ground, primarily as a result of the expansion of cable television, which now reaches 60 percent of American homes . . . . [as well as the expansion of other avenues of program distribution.][70]

As network power waned, and program outlets expanded, the necessity for the fin-syn rules diminished. At the same time, the nature of the programming industry had remained a risky business:

> The financial interest and syndication rules were hampering the entry of new firms into production by blocking an important mechanism (the sale of syndication rights) by which new firms might have shifted the extraordinary risks of their undertaking to the networks.[71]

Thus, the alleged benefits of the fin-syn rules remained tailored to a diminished evil, while the burdens associated with those rules continued to harm the programming industry. The rules were no longer -- if they were ever -- appropriate given the changed marketplace circumstances.[72]

b) The Movie Theater FTC Consent Decrees.

A similar example can be seen in the Federal Trade Commission's consent decrees with several movie distributors, whereby the distributors were restricted in the extent to which

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[70] Id. at 1046.

[71] Id.

[72] See Evaluation of the Syndication and Financial Interest Rules, Second Report and Order, 8 FCC Rcd 3282, at ¶ 12 (1993) (justifying the elimination of many of the Commission's fin-syn rules because of, inter alia, "ongoing marketplace changes since the 1991 rules").

they could own and operate movie theaters, or "exhibitors" -- companies that owned movie theaters. As in the case of the fin-syn rules, the movie theater decrees changed gradually over time due to changes in circumstances surrounding those industries.

For example, in United States v. Loew's Inc.,[73] the Second Circuit acknowledged changed marketplace circumstances in order to relax a restrictive consent decree. The decree in question required Warner Communications Inc. and Warner Bros., Inc. ("Warner") to obtain court permission in order to acquire ownership interests in exhibitors or theaters. In 1988, Warner acquired Cinamerica and sought permission to own and operate the company without first establishing a separate subsidiary for so doing. Though the District Court required such separation, the Second Circuit relied on the fact that the movie industry had changed in the intervening 40 years, thus dampening the likelihood of Warner distorting the movie program-distribution market, by inter alia: (1) foreclosing theater outlets to programmer-competitors of Warner; and (2) denying Warner programming to theater outlets not owned by Warner. Facing a complex program-distributor overlap similar to that which exists in the programming-cable industry today, the Second Circuit stated:

> [The] changed nature of the motion picture exhibition industry has made such foreclosure highly improbable. The growth of the motion picture aftermarkets of videocassettes, network, syndicated and cable television, and

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[73] 882 F.2d 29 (2d Cir. 1989).

> the development of national television advertising, have changed the business realities of the industry so that movie producers and distributors have every incentive to disseminate their products as quickly, and as widely, as possible.[74]

* * *

There are many parallels between the fin-syn and movie theater consent decree precedent and the cable horizontal ownership rules. Perhaps most importantly for the purpose of the Further NPRM, however, just as changed marketplace circumstances justified relaxing (or eliminating in the case of fin-syn) the government's prior ownership restrictions on the video distributors at issue, the significant changes in the MVPD marketplace described above that have occurred over the last five years at the very least justify relaxation of the cable horizontal limit as described in Section IV below.

III. GIVEN THAT MSOS HAVE NOT, AND LIKELY WILL NOT, ENGAGE IN THE BEHAVIOR TARGETED BY THE HORIZONTAL LIMIT, A HIGHER LIMIT IS WARRANTED TO PROMOTE THE SUBSTANTIAL EFFICIENCIES AND BENEFITS ASSOCIATED WITH LARGER MSOS, INCLUDING THE EXPANDED PROVISION OF COMPETITIVE LOCAL TELEPHONE AND INTERACTIVE BROADBAND SERVICES.

The discussion in the previous section demonstrates that the monopsony and vertical foreclosure concerns that underlie the cable horizontal limit are "vastly overstated"[75] and that increased MVPD competition, increased channel capacity, and the success and

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[74] Id. at 33.

[75] See Besen and Woodbury at 17.

strengthening of other Commission rules will further reduce these concerns going forward.

The case for increasing the horizontal limit is even stronger when one considers the substantial efficiencies and consumer benefits created by the existence of larger MSOs. As noted above, these efficiencies and benefits include lower marketing and transaction costs for programmers who negotiate with fewer larger entities as opposed to many smaller MSOs, and the development and financial backing of innovative programming.[76]

Perhaps most importantly, larger MSOs will be able to efficiently provide to more American consumers a competitive alternative to the local phone company. New technology and the geographic clustering of cable systems have made it possible for cable operators like TCI to provide local phone service in competition with incumbent LECs. Seen in this light, a higher horizontal limit is particularly warranted in order to enable cable operators to obtain a network reach or "footprint" sufficient to promote the extraordinary investment in new technology and system upgrades required to provide telephony to more American consumers. Purely theoretical concerns about monopsony and vertical foreclosure of programmers provide no basis to deprive a

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[76] See id. at 2-3. The Commission has also fully recognized that "consolidation in the cable industry produced significant benefits and efficiencies to consumers." 1993 Second Report and Order at ¶ 13.

significant number of American consumers of the actual benefits of a vibrant competitor to their local telephone provider.

Likewise, new technology and geographic clustering enhance TCI's ability to offer interactive video and content-rich, high-speed data services. Chairman Kennard has spoken plainly about the need to accelerate the provision of these services: "I don't care who wins the race to bring high capacity broadband services to America's homes ... my goals are simple: get this capacity into America's homes, get it there ... quickly...."[77] TCI cannot stress strongly enough that the ability to cluster cable systems and create significant reach are necessary predicates to realization of that goal.

TCI describes below the new technology and geographic clustering strategy that have made it possible for cable operators like TCI to provide competitive telephony and interactive broadband services and why a higher horizontal limit is required to ensure that such benefits are received by more American consumers.

A. Description Of Advancements In Cable Technology That Allow Cable Provision Of Competitive Local Telephony Services And Interactive Broadband Services.

Technology has advanced so rapidly that the cable system of today hardly resembles the cable system of 1993 when the Commission adopted the current horizontal limit. Digital technology was still

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[77] Remarks by William E. Kennard, Chairman, Federal Communications Commission, to the National Association of Regulatory Utility Commissioners, Seattle, WA, July 27, 1998, at 7.